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THE DIRECTOR OF
CENTRAL INTELLIGENCE

National Intelligence Council

31 October 1985

NOTE FOR: DDCI
FROM: Deane E. Hoffmann
Acting NIO for Economics
SUBJECT: Talking Points and Attachments

Attached are the talking points and some additional background material for the Friday NSC meeting on S. 812. I was told that Weinberger will speak on the deflection of Western credits to the Third World and Soviet uses of Western technology, citing the TTAC white paper which I have enclosed for you. Hence, your talking points will not be redundant with his presentation.


Deane E. Hoffmann

Attachments:
As Stated

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: DCI TALKING POINTS: NSC Meeting on Senate Bill 812

Western credits will play an increasingly important role in Moscow's economic plans over the next few years.

- Soviet hard currency earnings will decline over the next five years as oil production slips--a process that is already underway.
- At the same time, Moscow's needs for Western goods and technology will increase as Gorbachev attempts to modernize the economy and remedy problems in the energy sector.

The decline in oil earnings comes at an important time for Gorbachev.

- Oil exports account for roughly half of Moscow's \$32 billion in hard currency earnings.
- Their oil exports to the West have fallen by about a third in 1985 as production has declined.
- We expect earnings from oil will fall even further over the next five years, reducing total hard currency earnings to perhaps only two-thirds of current levels.

These financial difficulties will pose some real problems for Gorbachev as he tries to formulate plans to increase growth, modernize industry, and maintain or increase military spending levels.

- Imports of Western technology and equipment have been essential in the past to expanding Soviet industry in areas such as chemicals and transportation and are increasingly important today in electronics, machine tools, and robotics.

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- Western goods also play a key role in supporting the energy sector.
- The rapid construction of the Siberia-to-Western Europe gas pipeline, for example, would not have been possible without purchases of Western turbines, compressors, and pipe.
- The Soviets purchased almost \$20 billion in Western oil and gas equipment over the last 10 years to make up for deficiencies in Soviet goods and practices.
- These imports of Western equipment have also enabled Moscow to keep its best people working on defense while using imports to substitute for inadequacies in the civilian sector.

As Secretary Weinberger said, the Soviets also use these credits to purchase legal and illegal technologies to improve their military systems.

- We believe the Soviets spend about \$1.4 billion each year for acquisition of controlled technology and equipment.
- They spend several times that amount on purchases of equipment including "gray area" goods that we believe should be controlled.
- Indeed, we estimate that virtually every Soviet military research project--5,000 each year--benefits from Western legal and illegal technology.

As we look out over the next few years, we can see several areas where the Soviets will need Western equipment backed by credits which will have application in defense areas as well as broader applications for the economy as a whole.

- The Soviets plan to have approximately 120,000 robots in use in the machine tool industry by 1990.

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- They will need key electronic components such as controllers and computers from the West to achieve this goal.
- In microelectronics, where deficiencies in Soviet production technology are holding back advances in circuit complexity, they will be looking for high quality Western parts and equipment. These goods will also be used as components for the new generation of SAM systems and aircraft.
- Only 8 percent of large Soviet industrial facilities had mainframe computers in 1984; they will need US technology and equipment to expand the proliferation of these systems in the 1980s.

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In sum, Mr President, we see Soviet needs for Western goods accelerating as Gorbachev implements his ambitious economic agenda. And given the growing economic problems faced both by Moscow and its allies, increased use of Western credits are his best alternative for meeting these goals.

SUBJECT: DCI Talking Points: NSC Meeting on S. 812, 1 November 1985

Acting NIO/Econ(DHoffmann)

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DCI TALKING POINTS: NSC Meeting on Senate Bill 812

LIST OF ATTACHMENTS

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Progress and Problems

Attachment C: USSR: The Role of Foreign Trade in the Economy

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ATTACHMENT C

USSR: The Role of Foreign Trade in the Economy

Foreign trade plays an important, albeit not critical, role in Soviet economic development. Although the Soviet economy is largely self-sufficient--purchases from abroad account for only about 10 percent of GNP--imports have helped Moscow improve consumption, boost productivity, remove industrial bottleneck, and modernize weapon systems. [redacted]

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East-Versus West as a Source of Imports

The USSR has traditionally favored its communist allies in its foreign trade.

- o About 65 percent of the USSR's machinery and equipment imports come from its Communist allies, mostly the East European countries.
- o These imports represent nearly half of all Soviet purchases from Communist countries. (See Figure 1)

Although East European machinery and equipment is often of lower quality than Western equipment, it is equal to or better than Soviet produced goods in many instances. The USSR also looks to Communist countries for manufactured consumer goods to supplement its own production. More than half of such imports--primarily clothing and furniture--are purchased in Eastern Europe. [redacted]

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While relying on Eastern Europe for much of its machinery and equipment needs, imports of Western technology and equipment have been essential to expand selected Soviet industries (e.g. chemicals and automobiles), despite difficulties in assimilation.

- o Imported chemical equipment in the 1970s was largely responsible for the output of ammonia, nitrogen fertilizer, and plastics doubling during this period.
- o Construction of the Kama river truck plant, which is based almost exclusively on Western equipment and technology, has resulted in a roughly 100 percent increase in Soviet heavy truck output over the past decade.

Imports from the West also have played a key role in supporting the energy sector.

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- o The rapid construction of the Siberia-to-Western Europe gas pipeline would not have been possible without purchases of Western turbines, compressors, and pipe.
- o Difficiencies in Soviet drilling, pumping, and exploration have promoted Moscow to purchase almost \$20 billion in oil and gas equipment since 1975.

Imports of grain and other agricultural products have been the largest component of the USSR's western trade, however. A series of mediocre harvest during 1981-84 has pushed agricultural imports to record levels--with average annual purchases of some \$10 billion during this period. Because of the limited ability of Communist countries to expand grain production, Moscow has had to rely almost entirely on Western countries to fill the gap between domestic output and requirements.

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Finally, in addition to contributing to specific industrial sectors and overall consumer well-being, acquisition of goods and technology from the West has enhanced Soviet military programs.

- o Access to specific technologies has permitted improvements in a number of weapon and military support systems.
- o Gains from trade, in general, have improved the efficiency of the economy and thereby reduced the burden of defense.

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Foreign Trade Under Gorbachev

Since taking over as General Secretary in March, Gorbachev has made it clear that improved economic performance is his top priority. His plan focuses on modernizing the industrial base with more and better machinery--a strategy which could lead to an increased role in both Eastern Europe and the West.

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Gorbachev is undoubtedly hoping for an increase in the flow of machinery from Eastern Europe. Since taking over, he has spoken about the need for broader and tighter intergration within CEMA. While such rhetoric is not new--the USSR has long advocated joint production and specialization within CEMA as a means of getting the East Europeans to cough-up more--Moscow

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seems more intent than ever on pressing its allies to make firm commitments on this issue. In this regard,

- o An agreement signed by CEMA Prime Ministers in June pledged multilateral cooperation in designing and producing computer controlled systems.
- o The agreement follows a recent call in PRAVDA for a 50-100 percent increase in the rate of growth in machine-building in CEMA countries during 1986-90. [redacted]

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Moscow is probably limited in just how much it can get from its allies. Because most East European countries are constrained by their own resource and economic difficulties, any sharp increase in machinery exports to the USSR would have to come at the expense of much needed domestic investment or sales to the West that bring in hard currency. Such a shift would risk undermining growth prospects throughout the area which could cause serious political problems. [redacted]

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The limited prospects for sharply boosting imports from Eastern Europe increases Moscow's incentive to trade with the West. In particular, Gorbachev probably will look to the West for imports of technology and equipment for selected sectors--energy and electronics, for example--where no good supply alternatives exist. Moreover, Moscow is presently in a good financial position to increase its purchases of Western machinery and equipment--at least in the near-term.

- o With a relatively small debt and approximately \$10 billion in assets in Western banks at yearend 1984,

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Moscow can easily obtain commercial credits to finance new purchases.

- o Most West European countries are also offering generous terms on government-backed credits in an effort to balance trade with the Soviets and spur their own economies.

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Over the longer term, however, Moscow's financial position is much less certain--falling world prices for oil and declining domestic production could limit Soviet hard currency earning capacity.

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Looking to the US Prospects for an expansion of Soviet purchases of US machinery and equipment appear good--albeit from the extremely low levels of recent years. The share of machinery and equipment orders going to the US during first quarter 1985--10 percent--is substantially above last year's 6 percent figure and, if maintained, would be the highest since 1979. (See figure 4) Moreover, the US-Soviet Joint Commerical Commission talks in May 1985 produced a Soviet pledge to

- o Try to do more business with US firms.
- o Put interested US firms on bidders lists.
- o Fully consider US proposals on their economic merit.

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In this regard, we have seen an improved tenor in US-Soviet contract negotiations since the beginning of the year. The Soviets are currently discussing major deals with US firms for the sale of personal computers, energy equipment, and agricultural technology. Although these negotiations may be

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protracted, some signings appear likely. [redacted]

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Nevertheless, the vast majority of Soviet purchases from the US will continue to be agricultural products. Under the current long-term US-Soviet grain agreement (which expires in 1988), Moscow is committed to purchase a minimum of 8-9 million tons of grain per year, with a value of roughly \$1 billion at current world prices. In poor crop years, Soviet purchases can be expected to be much larger. [redacted]

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